

Message Text

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ACTION NEA-10

INFO OCT-01 ISO-00 NEAE-00 SP-02 USIA-06 AID-05 EB-07
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FM AMEMBASSY TEL AVIV
TO SECSTATE WASHDC PRIORITY 7302

LIMITED OFFICIAL USE SECTION 1 OF 2 TEL AVIV 5271

E.O. 11652: N/A

TAGS: EFIN, IS, ECON

SUBJECT: EHRlich ANNOUNCES NEW FISCAL MEASURES; ANOTHER
MINI-DEVALUATION

1. BEGIN UNCLASSIFIED. SUMMARY: IN A SURPRISE MOVE,
FINANCE MINISTER EHRlich ANNOUNCED ON JULY 17 A SERIES
OF FISCAL MEASURES DESIGNED TO CUT THE EXPECTED
BUDGET DEFICIT. HIGHER PRICES (25 PERCENT IN MOST
CASES) ARE EFFECTIVE IMMEDIATELY ON BASIC FOODS AND
SERVICES AS A RESULT OF A REDUCTION IN GOI CONSUMER
SUBSIDIES. OTHER CONTROLLED BUT NON-SUBSIDIZED ARTICLES
ARE ALSO BEING ALLOWED 25 PERCENT RISES. NON-WAGE
OUTLAYS BY GOVERNMENT DEPARTMENTS WILL BE CUT, INCLUDING
IL 1.4 BILLION OF THE DEFENSE BUDGET. THE PROJECTED
FY 77-78 DEFICIT WILL BE IL 4 BILLION. IN ANOTHER
MINI-DEVALUATION, THE ISRAELI POUND BASKET RATE FELL
1.9 PERCENT TO IL 9.98. THE OVERALL RESULT, WHICH
SHOULD PLEASE THE IMF, SHOULD BE TO LOWER MEDIUM-TERM
INFLATION BY REDUCING DEMAND. THE IMMEDIATE EFFECT
WILL BE A SHARP RISE IN THE COST OF LIVING--A
DEVELOPMENT SURE TO PROVOKE STRONG OPPOSITION FROM
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MANY POLITICAL AND LABOR GROUPS. END SUMMARY.

2. FINANCE MINISTER EHRlich ANNOUNCED ON JULY 17 A
SERIES OF FISCAL MEASURES DESIGNED TO REDUCE THE FY
77-78 BUDGET DEFICIT. CHANGES ON THE EXPENDITURE
AND REVENUE SIDES ARE INVOLVED.

3 THE MEASURES INCLUDE:

A. CUTS IN NON-WAGE OUTLAYS BY THE DEFENSE MINISTRY OF IL 1.4 BILLION AND THOSE OF OTHER MINISTRIES BY A TOTAL OF IL 900 MILLION. TOTAL EXPENDITURES, INCLUDING WAGES, FOR THE APRIL 1977 - MARCH 1978 PERIOD WILL BE IL 123.9 BILLION. REVENUES WILL GO UP ALSO, PARTLY BECAUSE OF THE FISCAL DIVIDEND IN TAXES FROM APPLYING EXISTING RATES TO INCREASED WAGES, AND PARTLY BECAUSE OF GOVERNMENT SALES OF GOODS AT INCREASED PRICES. TOTAL REVENUE WILL REACH IL 119.9 BILLION, LEAVING A DEFICIT OF IL 4 BILLION.

B. CUTS OF 1.4 BILLION IN SUBSIDIES OF BASIC FOOD ARTICLES (SUCH AS STANDARD BREAD, MILK AND CERTAIN MILK PRODUCTS, EGGS, EDIBLE OIL, MARGARINE, FROZEN CHICKEN, ETC.) AND OF PUBLIC TRANSPORT. PRICES OF SUBSIDIZED GOODS AND SERVICES WILL RISE BY AN AVERAGE OF 25 PERCENT.

C. PRICES OF CONTROLLED, NON-SUBSIDIZED ARTICLES (SUCH AS BUTTER, NON-STANDARD BREAD, CERTAIN CHEESES, ETC.) WILL ALSO GO UP BY ABOUT 25 PERCENT, EXCEPT SUGAR WHICH WILL GO DOWN IN PRICE BECAUSE OF THE FALL IN THE WORLD PRICE OF SUGAR.

D. IL 3 BILLION RISE IN REVENUE BY AN IMMEDIATE LIMITED OFFICIAL USE

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AVERAGE INCREASE OF 25 PERCENT IN PRICE OF FUEL (IL 2 BILLION) AND A SIMILAR HIKE IN ELECTRICITY RATES (IL 450 MILLION), POSTAL AND TELEPHONE RATES AND GOVERNMENT FEES (IL 400 MILLION), AND WATER RATES (IL 150 MILLION).

E. TWO PERCENT INCREASE IN RANGE OF INTEREST RATES ON SUBSIDIZED DEVELOPMENT LOANS AND DIRECTED CREDIT (SUCH AS LOANS FOR INDUSTRY, AGRICULTURE, AND INFRASTRUCTURE).

F. ADDITIONAL DEVALUATION OF 1.9 PERCENT AN I.E., FROM IL 9.79 TO IL 9.98 PER BASKET DOLLAR. NEW EFFECTIVE MARKET RATE PER US\$1.00 ON JULY 19 IS IL 9.72 COMPARED WITH IL 9.51 ON JULY 18. THIS IS THE 21ST IN A SERIES OF "CREEPING" DEVALUATIONS SINCE JUNE 1975, AND 11TH SINCE LINKAGE OF ISRAELI POUNDS ON JULY 19, 1976, TO BASKET OF FIVE CURRENCIES.

G. OLD-AGE PENSIONERS, LARGE FAMILIES (WITH MORE THAN FOUR CHILDREN), INVALIDS, WELFARE-PAYMENTS RECIPIENTS WILL RECEIVE IMMEDIATE 5-6 PERCENT

SPECIAL COMPENSATION FROM THE NATIONAL INSURANCE INSTITUTE OR FROM THE MINISTRY OF SOCIAL WELFARE, AS AN ADVANCE ON THE COST-OF-LIVING ALLOWANCE PAYABLE IN OCTOBER 1977 AND APRIL 1978. CHILDREN'S ALLOWANCES WILL REMAIN 100 PERCENT LINKED. IN ADDITION, MORE INCOME-TAX CONCESSIONS WILL BE ACCORDED FOR TRAVEL EXPENSES AND PROVIDENT-FUND CONTRIBUTIONS.

H. THERE WILL BE A FREEZE IN HIRING OF NEW CIVIL SERVANTS WITH THE EXCEPTION OF PERSONNEL FOR HEALTH, EDUCATION, AND TAX-COLLECTION SERVICES.

4. THE CHANGES IN THE BUDGET WILL HAVE TO BE APPROVED BY THE KNESSET, ALTHOUGH THE ANNOUNCED RISE IN THE LIMITED OFFICIAL USE

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PRICES WILL GO INTO EFFECT IMMEDIATELY. END UNCLASSIFIED.

5. BEGIN LIMITED OFFICIAL USE. COMMENT: AS NOTED IN TEL AVIV 5022 AND PREVIOUS, THE NEW GOVERNMENT WAS FACED WITH A PROJECTED IL 13 BILLION BUDGET DEFICIT DUE TO THE WAGE INCREASES AUTHORIZED IN THE PRE-ELECTION PERIOD. THE NEW MEASURES ARE AIMED AT RESTRAINING EXPENDITURES AND HIKING REVENUE TO KEEP THE BUDGETARY DEFICIT MORE OR LESS IN LINE WITH EARLY 1977 ORIGINAL PROJECTIONS OF ABOUT IL 5 BILLION.

6. WITH NEAR FULL EMPLOYMENT (FIRST QUARTER STATISTICS SHOW UNEMPLOYMENT AT ONLY A 3.4 PERCENT LEVEL), THE EXPANSIONARY FISCAL POLICY IMPLIED BY THE EXPECTED DEFICIT WOULD CLEARLY HAVE CONTRIBUTED TO A NEW

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FM AMEMBASSY TEL AVIV

TO SECSTATE WASHDC PRIORITY 7303

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ROUND OF DEMAND-PULL INFLATION. MONETARY POLICY HAS BEEN HAMPERED BY THE GOI'S PRACTICE OF BORROWING FROM THE CENTRAL BANK TO FINANCE THE DEFICIT, SO IT IS DOUBTFUL THAT MONETARY MEASURES ALONE COULD HAVE OFFSET INFLATIONARY FISCAL POLICY. IN THE SHORT RUN, HIGHER PRICES FOR GOODS AND SERVICES AND THE MINI-DEVALUATION WILL CONTRIBUTE SOMZWHAT TO COST-PUSH PRICE RISES (THE GOI ESTIMATES 6 PZRCENT). HOWEVER, THE OUTLOOK FOR CONTROLLING INFLATION IS BETTER IN THE LONG RUN. NEVERTHELESS, MORE HARD CHOICES WILL HAVE TO BE MADE TO ELIMINATE ISRAEL'S MANY BASIC ECONOMIC PROBLEMS.

7. THE JULY 17 STEPS WOULD HAVE BEEN NECESSARY NO MATTER WHICH PARTY WAS IN POWER. INDEED, IT IS OUR UNDERSTANDING THAT THE MAIN POINTS OF THHE PROGRAM WERE DRAWN UP BY THE LABOR GOVERNMENT TO BE IMPLEMENTED AFTER THE ELECTIONS. THE NEXT TEST OF THE LIKUD WILL BE HOW WELL ITS PROPOSALS ARE IMPLEMENTED--A PHASE IN WHICH LABOR FREQUENTLY GOT POOR MARKS. THE GOI CAN EXPECT STRONG CHALLENGES FROM THE ALIGHMENT, THE LIMITED OFFICIAL USE

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HISTADRUT, AND EVEN SOME OF THE MORE POPULIST HERUT SUPPORTERS WITHIN THE LIKUD AS T IT ATTEMPTS TO MOVE ISRAEL TO A MORE FREE-MARKET ECONOMY. END COMMENT. END LIMITED OFFICIAL USE.

8. BEGIN UNCLASSIFIED. REACTIONS FROM MEMBERS OF THE LABOR OPPOSITION WERE QUICK AND CAUSTIC, WITH SHIMON PERES ASSERTING THAT THE LIKUD HAD BROKEN EVERY ONE OF ITS PRE-ELECTION PROMISES; HE WAS PARTICULARLY CRITICAL OF THE LIKUD GOVERNMENT CUTTING THE DEFENSE BUDGET AFTER HAVING OPPOSED CUTS IN DEFENSE SPENDING WHILE IN OPPOSITION. EX-COMMERCE MINISTER BAR-LEV TERMED THE MEASURES A BADLY THOUGHT-OUT PROGRAM WHICH WOULD HURT ALL CITIZENS. THE HISTADRUT LEADERSHIP HASO PROTESTED THE UNILATERAL NATURE OF THE ACTION; IT IS MEETING TODAY TO DISCUSS THE SITUATION. HISTADRUT

SECRETARY-GENERAL YERUHAM MESHEL ATTACKED THE SEEMING CONTRADICTION OF A POLICY OF ATTEMPTING TO HOLD DOWN INFLATION BY INCREASING THE PRICES OF BASIC COMMODITIES. ON THE OTHER HAND, BOI GOVERNOR GAFNI WELCOMED THE MOVE, ALTHOUGH HE HAD SOME RESERVATIONS ON PARTICULAR POINTS. AVRAHAM SHAVIT, HEAD OF THE MANUFACTURERS ASSOCIATION, ALSO BACKED THE PROGRAM, ADDING THAT MUCH MORE HAS YET TO BE DONE TO PUT THE ECONOMY ON THE RIGHT PATH.

9. EHRLICH'S ANNOUNCEMENT OCCURRED TOO LATE FOR MOST OF THE MORNING DAILIES TO COMMENT. IN LIMITED REACTION SO FAR, DAVAR (HISTADRUT) STATES THAT THE PROGRAM DOES NOT CONSTITUTE AN ECONOMIC RECOVERY PLAN THAT WILL RENEW ECONOMIC GROWTH AND ARREST INFLATION. THESE MEASURES HIT THE POOR AND MIDDLE CLASSES OF SOCIETY WHICH ARE MORE DEPENDENT ON SUBSIDIZED GOODS AND LIMITED OFFICIAL USE

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SERVICES. IT PREDICTS AN ACCELERATION OF INFLATION IN A CHAIN REACTION FOLLOWING THE RISE IN PRICES OF STAPLES, FUEL, WATER, AND ELECTRICITY. AL HAMISHMAR (MAPAM) COMPLAINS THAT AVERAGE MONTHLY FAMILY EXPENDITURES WILL INCREASE 12 TO 15 PERCENT, WHEREAS COST-OF-LIVING ALLOWANCE WILL ONLY PARTLY COMPENSATE WAGE EARNERS, AND NOT BEFORE APRIL 1978. ON THE OTHER HAND, THE RICH ARE NOT TAXED ON CAPITAL GAINS AND PROFITS DUE TO INFLATION. HATSOFEH (RELIGIOUS) APPROVED THE FINANCE MINISTER'S ACTION.

10. FURTHER EMBASSY ANALYSIS WILL FOLLOW.
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